Michelin: a commodity-based industry

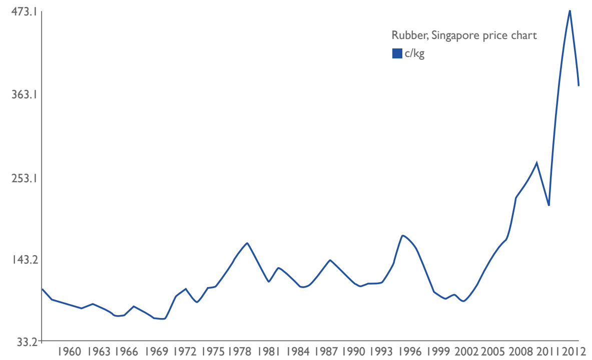
Eric Le Corre, Managing Director of **Michelin UK** tells **Patrick Gougeon**, UK Director of **ESCP Europe Business School**, how a company manages its risk exposure when it is as dependent on a single agricultural commodity as tyre manufacturer Michelin is on rubber

Your company is exposed to commodity risk, which commodities?
Michelin spends €7 billion per annum on commodities (2011 figure), to be compared to €21 billion net sales. The bulk of that is spent on rubber: Natural Rubber accounts for 42% of the total spend, synthetic rubber for 24%, the remainder is fillers, chemicals, steelcords and textiles

So, rubber purchases amount to about €3 billion, that is nearly 15% of sales. How is the rubber market organised?
Worldwide Natural Rubber production amounted to 10.7 million tonnes in 2011, and the supply grows at a 3% per annum pace. Tyre manufacturers purchase 70% of the world's natural rubber production. On average a passenger car tyre contains 15-18% Natural Rubber, a heavy truck tyre 40%. Southeast Asia is the main producer – Thailand, Indonesia and Malaysia account for close to 70% of the world's production – and contrary to a common perception, 85% of plantations are very small with only few hectares, and belong to small village farmers. This industry employs some 6 million people directly around the world and some 20 million indirectly.

Natural Rubber, once collected from rubber trees, is transformed through remilling plants that wash it (removing leaves, insects, dirt, etc.), blend it (to ensure consistency), dry it and package it before selling it on in the form of either smoked rubber sheets (SSR) or bales of rubber (TSR).

Figure 1: Evolution of rubber
Compiled by mongabay.com
using figures from World Bank Commodity Price Data



Rubber prices (see Figure 1) are volatile and influenced by many different factors. How is your business impacted and how do you handle the risk?
Over the past decade natural rubber prices have increased three to four fold, from less than $1 per kilogram to above $4.5 at some point. In addition to the increase we have also witnessed increased volatility of the prices. A recent study from the European Tyre & Rubber Manufacturers' Association (ETRMA) has actually highlighted that the current imbalance between supply and offer on a worldwide basis cannot fully explain the volatility of prices.

As a company, Michelin's main objective is to guarantee a 100% on-time delivery of Natural Rubber to our manufacturing plants around the world, whilst respecting the specified quality. We aim to achieve the best cost but also do factor in the long term: we do not necessarily go for the cheapest price – which may jeopardise delivery – nor do we go for short term 'coups' which may endanger our sourcing. We really emphasise visibility of our supply.

Natural Rubber has, of course, an impact on the cost of manufacturing a tyre, but the more sophisticated and technical the tyre, the less natural rubber represents of its total cost. So premium tyre manufacturers are proportionately less impacted than budget ones by the natural rubber price rises and volatility.

Do you have an organisation in place for real time assessment of your commodity exposure?

Since 1927 we have had a dedicated subsidiary, SMPT (Société des Matières Premières Tropicales), based in Singapore, which acts as sole supplier of Michelin Group's Natural Rubber needs. It buys on all markets and guarantees our manufacturing plants across the world a one hundred per cent on-time delivery of their needs. Since 2012 it has also housed Michelin Group's rubber tree agricultural expertise pole.

In order to be effective in our buying it is critical for us to know all the players in the industry, be they farmers, remillers, states or manufacturers. Michelin also aims to help make the market more transparent (by supporting the International Rubber Study Group, IRSG) through better information on supply and demand. It also promotes socially responsible farming through the promotion of a Green Label for the Natural Rubber *filière*, for instance.

To what extent can you pass changes in commodity prices through to your sales price?

Given the use it makes of Natural Rubber to enhance the performance of its tyres, Michelin is able to pass Natural Rubber price increases through to its customers.

Do you consider hedging too expensive and just accept the risk?

It is not that it is too expensive, but simply given the size of the market and the share of the world production of Natural Rubber that we purchase, it is simply not possible from a practical standpoint... Through better transparency of the market, knowledge of all players and stakeholders and acting responsibly and with anticipation we can somewhat smooth out the volatility of prices.

Could vertical integration be a natural hedge?

Very few tyre manufacturers own Natural Rubber plantations and these only account for a small proportion of their needs. Out of the three global tyre manufacturers, Bridgestone controls approximately 40% of its needs through its plantations in Liberia and Indonesia. Given the price of farm land today acquiring plantations would be very expensive and would not bring a significant competitive advantage.

Rubber being extracted from a tapped rubber tree

Could you deal with the risk on this commodity through substituting Natural Rubber with other commodities?

Natural Rubber comes from latex, a liquid that flows from the bark of the rubber tree when it is cut. Many plants produce latex, whose function is to protect them, but so far only Natural Rubber lends itself to economically efficient farming and provides the right level of performance we are looking for. The many properties of Natural Rubber cannot be fully reproduced in laboratories.

We obviously explore the different ways likely to help us reduce our dependency on Natural Rubber through using renewable natural resources. Our objectives are at the same time technological, environmental and economical ones. The aim is to properly master performing raw materials at competitive market prices. Diversity of supply is of course a factor that will help us stabilise prices, and reduce volatility. ■